Thai banks may spurn SME loan pleas

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Despite the military government's push to increase their lending to SMEs, in their current state commercial banks are instead seeking to diversify their revenues. They will expand credit to SMEs to a degree, but many such firms will continue to rely on state-backed institutions and informal lenders.

Thailand's recent military coup has brought renewed focus on Thailand's flagging economy, which will impact the country's banking sector on the eve of integration with the ASEAN Economic Community (AEC). The military junta, known as the National Council for Peace and Order (NCPO), is particularly focused on small to medium-sized enterprises (SMEs), whose growth has suffered from prolonged political uncertainty and risk-averse banks reluctant to make loans.

The NCPO is eager to reverse this trend, and has proposed a number of measures designed to increase financial access for SMEs and to spur banks to expand lending. However with high household indebtedness and lingering political uncertainty, Thailand's major lenders are looking to diversify their revenue flows to fee-based income at home and neighbouring markets abroad. As a result, SME loan growth in Thailand will require continued assistance from state financing institutions.

Slowing loan growth

Months of political uncertainty have taken their toll on the Thai economy. Loan growth slowed to 9.8% in the first quarter of 2014, from 11% in Q1 2013. Political disruption has affected the operations of SMEs, whilst a lack of income saw household indebtedness soar. Legal ambiguity further depressed Thai banks' lending appetite, as lenders were uncertain whether the previous caretaker government led by Yingluck Shinawatra had the authority to guarantee debt needed to finance government spending.

Household indebtedness rose to 82% of GDP in 2013, a figure that does not include loans from informal lenders, rumoured to total US$74bn. Loan performance deteriorated, with gross non-performing loans rising to 2.3% in Q1 2014, mainly on consumer and SME loans.

Some banks, such as Kasikornbank (KBank) and Bangkok Bank (BBL) - two of the nation's largest SME lenders - have already restructured a number of their SME loans via interest rate reductions and extended their principal repayment terms. KBank also tightened its credit card approval criteria in response to increasing household debt.

Economic revival

Upon assuming power, the NCPO has set about restoring economic growth through pledges of increased government spending and encouraging a revival of bank lending, particularly to SMEs. Their first act was to complete payments to Thai rice farmers, owed money under the previous government's controversial rice subsidy scheme. The government funded the payments through a Bt50bn (about US$1.6bn) loan from the Government Savings Bank (GSB), which won the mandate in a strongly contested auction in June.

The auction signalled a return of appetite by domestic banks for government debt, buoyed by the restored debt guarantee, and bullish on the NCPO's plans for economic growth. The loan was contested by 12 major banks, and attracted an interest rate of 2.179% - a rate lower than three-year government bonds. Strong domestic demand has also reduced reliance on offshore debt investors.

The NCPO is also encouraging banks to expand their lending to local SMEs by increasing loan guarantees from the Thai Credit Guarantee Corporation (TCGC). Previously the TCGC guaranteed 18% of the value of loans. Now it is set to increase this to 50%, and waive its annual fees. The Bank of Thailand has also encouraged a revision of eligible collateral for SMEs, which would provide them with a greater borrowing capacity.

The GSB recently pledged to provide Bt10bn in further loans and venture capital, in an effort to boost the working capital of 12,000 SMEs. However with the number of SMEs estimated to be over 2 million, the reach of such a programme is limited.

Banks are focused on regional and domestic growth

Thai banks have remained well capitalised with stable credit ratings throughout the recent political turmoil. Many of them are pursuing domestic and regional growth strategies. KBank, for example, recently committed to expanding in Thailand's outer provinces, with the goal of having half its customer base in Thailand's outer provinces to balance those in Bangkok. Such commitment is an encouraging sign for greater loan growth in Thailand's credit-starved outer provinces.

However all of Thailand's major banks appear set on pursuing growth in the southeast Asian region, encouraged by greater economic integration through the AEC. CIMB Thai Bank, majority-owned by Malaysia's CIMB Group, recently announced its intention to increase its corporate banking revenue by supporting its large and medium-sized corporate clients in the ASEAN market. It is also expanding other services such as its international money transfer system in anticipation of increasing remittance demand within the AEC.

All four of Thailand's largest lenders – Bangkok Bank, Krungthai Bank, Siam Commercial Bank and KBank - are seeking an expanded presence in Myanmar, as operating licenses for foreign banks are granted. The picture is not all one-sided - the Australian and New Zealand Banking Corporation and Japan's Sumitomo Bank recently received subsidiary licenses from the previous government, to operate in Thailand.

Concern over debt-driven growth

The NCPO's debt-laden government spending push carries risks, with offshore investors showing increased concern. The government's last three sovereign bond sales have fallen short of their targets. Should Thai banks also become more bearish on government debt, the NCPO's low borrowing costs may come under pressure, potentially placing its spending plans under strain.

With improved economic sentiment due to a perceived return to political stability, many observers are optimistic about Thailand's economy. However with household indebtedness likely to remain elevated, and SMEs continuing to pile up bad loans, many Thai banks are looking elsewhere. With AEC integration due in late 2015, they appear wary of becoming tied to a tepid and politically fragile local economy. For the time being, credit for SMEs will not come from the private sector alone, but will continue to depend on expanded government support via state-owned institutions and informal lenders.

Source: Industry Briefing